

Nos. 21894, 21894-A, 21894-B, 21894-C

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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JORDANOS', INC., MADELINE F. JORDANO, HOWARD H.  
KING and DELFINA I. KING, HELEN M. JORDANO  
*Petitioners on Review,*  
*vs.*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent on Review.*

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## BRIEF FOR APPELLANTS.

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and  
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**FILED**

NOV 13 1967

WM. B. LUCK, CLERK

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## BRIEF FOR APPELLANTS.

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### Jurisdiction.

These appeals are brought to review the decision of the Tax Court of the United States. The Tax Court had jurisdiction under Section 7442 of the Internal Revenue Code of 1954, and this Court has jurisdiction to review the judgment under Section 7482(a) of the Internal Revenue Code of 1954. The pleadings showing the existence of these jurisdictions will be found at pages 1, 18, 31, 44, 108, 114, 119 and 124 of the Transcript of the Record.

### Statement of Case.

This controversy was occasioned by the deduction by petitioner, Jordanos', Inc., of certain payments to widows of deceased employee stockholders, and the failure of the said widows to include such payments in their returns as income.

By stipulation, the only issues to be determined are the deductibility of the payments in the amount of \$13,200.00 by petitioner Jordanos', Inc., for the taxable year ended June 30, 1961, and the inclusion of the payments of \$4,440.00 received by each of the petitioners, Madeline F. Jordano, Delfina I. King and Helen M. Jordano, as income in each of the years ended December 31, 1958, 1959 and 1960. [Clk. Tr. p. 6, line 21, to p. 7, line 2.]

A fair conclusion of the factual situation is as follows:

1. Petitioner, Jordanos', Inc., is a California corporation which owns and operates a chain of grocery stores, distributes meat and produce as a wholesaler and acts as a wholesale distributor for beer in and around Santa Barbara County, California. [Tr. of Rec. p. 63.]

2. Petitioner, Jordanos', Inc., regularly keeps its books and prepares its income tax returns on a fiscal year basis ending June 30, and on an accrual method of accounting. It filed a timely return for the fiscal year ended June 30, 1961. [Tr. of Rec. p. 76.]

3. Petitioner, Jordanos', Inc., is the present successor to a grocery business partnership originally started by four brothers, Dominic Jordano, Frank Jordano, John Jordano, Sr., and Peter Jordano, upwards of forty years ago in Santa Barbara, California. The partnership business was transferred to a corporation in 1928, transferred back to a partnership in 1944, and again transferred to a corporation, the present petitioner, in 1946, but at all times the business was and is owned in approximately equal shares by the

founding brothers or their wives and/or children. [Tr. of Rec. pp. 65, 66 and 76.]

4. On November 27, 1931, Peter Jordano died. At the time of his death he was a director and shareholder of Jordano Bros., Inc. At the time of Peter Jordano's death petitioner Delfina I. King was Peter's surviving spouse. [Tr. of Rec. pp. 66 and 78.]

5. On August 3, 1944, Dominic Jordano died. At the time of his death he was a director, shareholder, and the president of Jordano Bros., Inc. Petitioner Madeline F. Jordano is the surviving widow of Dominic Jordano. [Tr. of Rec. pp. 66, 67 and 78.]

6. On January 20, 1956, John Jordano died. At the time of his death he was a director, shareholder, and the president of the corporation. Petitioner Helen M. Jordano is the surviving widow of John Jordano. [Tr. of Rec. pp. 67 and 79.]

7. Upon the deaths of each of Peter Jordano, Dominic Jordano and John Jordano, Sr., the business began making payments of \$370.00 per month to their widows. [Tr. of Rec. pp. 67, 78 and 79.]

8. Petitioner Jordanos', Inc., has from the time of its incorporation continued the payments to the widows pursuant to the following and other similar resolutions:

WHEREAS, for some time past this corporation has paid to Delfina Jordano the sum of \$370.00 per month, in semimonthly payments of \$185.00, and has paid similar amounts to Madeline Jordano, and

WHEREAS, said payments, and each of them, constituted pension payments to said individuals,

having been based wholly upon their needs and their lack of other adequate means of support and without obligation on the part of this corporation to make or continue to make such payments, and WHEREAS, said payments have been made from their inception, with the authorization of this board and with the consent of all its shareholders, upon the understanding and with the intent that all such payments would be wholly gratuitous, terminable at will by this corporation and without obligation of repayment, and

WHEREAS, said payments have been erroneously and without authority charged against the accounts with this corporation of said Delfina Jordano and Madeline Jordano,

RESOLVED, that all simimonthly pension payments of \$185.00 by this corporation to Delfina Jordano and Madeline Jordano are hereby ratified and approved as gratuities for which the corporation has never expected or intended to receive reimbursement, and

RESOLVED FURTHER, that all erroneous entries in the corporate books and records, charging said semimonthly payments against the accounts of said Delfina Jordano and Madeline Jordano, be corrected by appropriate book entries reversing said charged; and

RESOLVED FURTHER, that for the fiscal year beginning July 1, 1953 and ending June 30, 1954, this corporation continue to pay the sum of \$370.00 per month to Delfina Jordano, and a similar sum to Madeline Jordano, as gratuities, sub-

ject to termination by this board at any time during said year and without any obligation to make or continue to make such payments for any period.

WHEREAS, Madeline Jordano and Delfina Jordano, widows of Dominic Jordano and Peter J. Jordano, respectively, have been in need of financial assistance at all times since June 30, 1954, to date, and

WHEREAS, the corporation without obligation on its part so to do and with the full consent of all members of the Board of Directors has made semi-monthly payments of \$185.00 to each widow from June 30, 1954, to date, and

WHEREAS, said payments and each of them constituted gifts to said individuals, having been based wholly upon their needs and their lack of other adequate means of support and without obligation on the part of this corporation to make or continue such payments, and

WHEREAS, said payments have been made with the knowledge and consent of all of the shareholders and upon the understanding and with the intent that all such payments would be wholly gratuitous, terminable at will by this corporation, and without obligation of repayment,

RESOLVED, that all semi-monthly payments of \$185.00 made by this corporation to Madeline Jordano and Delfina Jordano for the period from June 30, 1954, to date be hereby ratified and approved as gratuities made without obligation or expectation of repayment.

RESOLVED, FURTHER, that subject to the approval of the stockholders of the corporation and until further action by the Board of Directors, this corporation continue to pay the sum of \$370.00 per month to Madeline Jordano and a similar sum to Delfina Jordano as gratuities, and without obligation or expectation of repayment on their part, and subject to the following conditions which are expressly made a part of this resolution:

(1) That the corporation is recognized to be under no legal obligation to make any pension payments or other payments to them as the widows of Dominic Jordano and Peter J. Jordano, and that they possess no legal right to enforce any gratuities or pension payments whatsoever from the corporation.

(2) That said payments are expressly conditioned on the corporation's being financially able to make the same without any impairment to or hardship on its financial structure.

(3) That said payments are to be in any event terminable at the will of the corporation and subject to the approval of the stockholders. [Tr. of Rec. pp. 67 and 80.]

9. The Board of Directors of petitioner Jordanos', Inc., in passing such resolutions and authorizing such payments were motivated principally by the financial needs of the widows. [Clk. Tr. p. 17; Tr. of Rec. p. 80, lines 23-25, p. 18, lines 1-7, p. 20, line 25, p. 21, lines 1-5, and p. 22, lines 4-23.]

10. During the fiscal year ended June 30, 1961, petitioner Jordanos', Inc., took a deduction in its income tax return in the amount of \$13,200.00 which represented the payment to the widows during that fiscal year. [Tr. of Rec. p. 80.]

11. Petitioners Helen M. Jordano, Madeline F. Jordano, and Delfina I. King each filed timely income tax returns on the cash receipts and disbursements basis for the calendar years 1958, 1959 and 1960. They did not include as income in their returns the amounts of \$4,440.00 received each year by each petitioner, from petitioner Jordanos', Inc. [Tr. of Rec. p. 80.]

12. Each of the petitioners Helen M. Jordano, Madeline F. Jordano and Delfina I. King, are women of modest means who do not have sufficient property or income to maintain themselves without the payments to them by petitioner Jordanos', Inc. [Tr. of Rec. p. 81.]

### Specification of Errors.

1. The Tax Court erred in its Decision that there are deficiencies in income taxes due from petitioner Jordanos', Inc. to the extent that such deficiencies arose from the disallowance as a business expense of the payments made to the individual petitioners. This decision [Tr. of Rec. p. 89] is not supported by any finding of the Court. The Memorandum Findings of Fact and Opinion [Tr. of Rec. pp. 75 through 88] nowhere contains any finding as to whether or not the payments were a reasonable and necessary business

expense as contended by petitioner Jordanos', Inc. In its opinion the Court stated only “. . . Under the circumstances we hold that the payments did not constitute compensation for services or otherwise reflect any reasonable benefit to the Corporation. . . .” [Tr. of Rec. p. 84.] That does not constitute a finding that the payments were not a reasonable and necessary business expense.

2. The Tax Court erred in its finding that the payments to the widows constituted a distribution of earnings and profits, and therefore a dividend by the corporation to three of its major stockholders. [Tr. of Rec, p. 82.]

The Court in making this finding ignored its own findings that the payments were made voluntarily by the Corporation without any consideration to it [Tr. of Rec. p. 80], were based wholly upon the widows' needs [Tr. of Rec. p. 80], and that none of the widows were ever a director. [Tr. of Rec. p. 80.]



## ARGUMENT.

### 1. Deductibility of Payments Made to Widows.

The Internal Revenue Service and the Courts have long recognized the deductibility of a payment to a widow under the usual situation where the payment is prompted by mixed motives, which include not only a desire to assist the widow in mitigating the loss of her financial support but also a desire to obtain for the employer a benefit through increased morale or good will of the other employees and officers.

In 1939, under I. T. 3329, the Internal Revenue Service stated:

“Payments made . . . to the widow of an officer stockholder . . . though not required to be made by any contractual obligation, are deductible by the corporation as business expenses. Such amounts are gifts to the widow, and, therefore, are not taxable income to her.”

The Courts have long recognized the deduction. *Champion Spark Plug Company*, 30 TC 26; *Fifth Avenue Coach Lines*, 31 TC 111; *Paterson Vehicle Company*, 20 TCM 774, Dec. 24,867 (M), T.C. Memo 1961-154.

In general, payments of premiums on insurance on the lives of employees are deductible by the payor corporation and similarly payments made into a profit sharing or pension fund are deductible by the payor corporation. *L. O. 1014*, 2 CB 88; *Sec. 404(a) I.R.C., 1954*.

Petitioner, Jordanos' Inc., in making the payments to the widows was carrying out a policy of the company

established many years prior by which the company, at a time when group insurance and pension plans were largely unheard of, could assure its principal officers that their widows would be cared for in the event of an early demise. Unquestionably this policy attracted and held qualified executives as each son of the original founding brothers gradually worked into the company and eventually became, and stayed, an executive. That this was a successful plan is seen in the fact that the business grew from a local grocery store in its inception to a corporation doing in excess of \$20,000,000.00 per year gross receipts.

The relatively small amounts paid to the widows can certainly be found to be “reasonable” under the circumstances.

## 2. Taxability of Payments Received by Widows.

It is accepted practice in our modern business community for an employer voluntarily to make payments to the widow of an employee following the death of a husband. The district courts have steadily and consistently found that voluntary death payments were tax free to the widow.

*Reed v. United States*, 177 F. Supp. 205 (D.C. Ky., 1959), affirmed 277 F. 2d 456 (6th Cir. 1960);

*Cowan v. United States*, 191 F. Supp. 703 (D.C. Ga., 1960);

*Frankel v. United States*, 192 F. Supp. 776 (D.C. Minn., 1961), affirmed ..... F. 2d .... (8th Cir., 1962);

*Wilner v. United States*, 195 F. Supp. 786 (D.C. N.Y., 1961);

*Rice v. United States*, 197 F. 2d 223 (D.C. Wis., 1961);

*Kasynski v. United States*, 284 F. 2d 143 (10th Cir., 1960).

The Tax Court shared this inclination for a long time; however, after the Supreme Court's decision in *Duberstein v. Commissioner*, 363 U.S. 278 (1960), the Tax Court shifted its position.

Following the decision in *Duberstein*, the Tax Court handed down a decision in *Estate of Mervin G. Pierpont*, 35 TC 65 (1960), (reversed and remanded sub. nom. *Poyner v. Commissioner*, 301 F. 2d 287, 4th Cir., 1962) adverse to the widow, which provided a foundation for a string of Tax Court cases all holding that the payment to the widow was taxable income.

*Roy I. Martin*, 36 TC ..... (1961), on appeal C. A. 3;

*Mary C. Westphal*, 37 TC ..... (1961);

*Estate of Martin Kuntz, Sr.*, 19 TCM 1379 (1960), reversed 300 F. 2d 849 (6th Cir., 1962);

*Estate of W. R. Olsen*, 20 TCM 807 (1961), reversed ..... F. 2d ..... (8th Cir. 1961).

However, recently the widow has dealt the Tax Court a deadly blow by upsetting its post-*Duberstein* rationale on three separate occasions before three different Courts of Appeal. (*Poyner v. Commissioner*, *supra*; *Estate of Martin Kuntz, Sr.*, *supra*; and *Estate of W. R. Olsen*, *supra*.)

In perhaps the most resounding defeat dealt the Tax Court, the Eighth Circuit in the *Olsen* case, *supra*,

flatly rejected the *Pierpont* rationale and refused to send the case back to the Tax Court for further proceedings. The Court pointed out that there was no obligation or duty on the employer to make a payment to the widow. It noted that the only reasonable inference to be drawn from the undisputed evidence was the payment to the widow was a gift.

The significant factors generally considered to be determinative, that a payment to a widow constitutes a gift, as set forth in *Arthur W. Hellstrom*, 24 TC 916 (1955) are that the payments are made to the widow, not the estate; that there was no obligation to make the payment; that there was no benefit to the corporation from the payment; that the widow rendered no services to the corporation, and that the decedent had been fully compensated for his past services.

The case at bar seems to contain all of the necessary ingredients to constitute a gift within the meaning of the tax law.

The payments in each case were made directly to the widow. There was no legal obligation on the part of the corporation to make payments. As to the question of moral obligation the 8th Circuit Court has disposed of this assertion in *Estate of Olsen v. Commissioner*, 302 F. 2d 666 (CA-8), cert. denied 371 U.S. 903, by observing

“ . . . We are not aware that a corporation has any moral obligation or duty to make any payment to a widow of a deceased officer or employee who, while he lived, was fully compensated for his services. . . . ”

The widows here rendered no services to the corporation, and no benefits flowed to the corporation by virtue of the payments. The deceased officers were fully compensated.

Thus it appears from the record that this Court has adequate grounds for finding a gift based upon the factors generally conceded to be controlling and specifically on the test given in *Commissioner v. Duberstein*, 363 U.S. 278, that of a transfer proceeding from a “detached and disinterested generosity” or of feelings of “affection, respect, admiration, charity or like impulses.”

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and  
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### Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JERRY F. BROWN

